Increased Investment in AV Industry Causing Rigorous Due Diligence of Employment-Related Issues

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With traditional automakers and tech-companies continuing to develop AVs, venture capitalists are increasing their attention and investment activity in our industry. Likewise, traditional automakers and large tech companies have acquired AV-tech startups as competition for key personnel, technology, and first-mover advantage increases.

In the third quarter of 2018, venture capitalists invested $1.9 billion in auto tech companies according to a MoneyTree report from CB Insights and PricewaterhouseCoopers.

The increase in investments in AV-related companies is remarkable when considering the history of investment in the industry. Since the end of 2016, automotive technology has typically garnered between $100 million and $350 million per quarter in investment funding.

Competition to secure investments in the AV industry will likely continue to increase due to traditional automakers and tech companies competing to develop commercial autonomous ride-share services. Due to the intense competition, tech start-ups continue to be acquired by traditional automakers who need in-house technical specialists and advanced lidar technology.

As a result of increased competition in the AV industry, talent is at a premium. Consequently, venture capitalists and companies investing in and acquiring AV tech startups should conduct even more rigorous due diligence related to key executives, trade secrets, confidential information, and non-competition agreements.

For many tech start-ups, their value is found in key executives and trade secret information related to the development of lidar technology.

With regard to non-competition agreements, acquiring companies should review the structure of their deal and make sure that non-competition agreements are assignable and that the restrictive covenants are enforceable. Because employees may be located in different states, a state-by-state analysis can be critical. In addition to non-competition agreements, acquiring companies should also develop an attractive employee retention plan for key employees.

Additionally, buyers should ensure that target companies have adequate proactive measures in place to ensure trade secrets retain their value after the investments/acquisitions are completed.

Protective measures should include well-written policies and procedures, sufficient confidentiality/non-disclosure agreements, and electronic protocols designed to prevent or discover electronic theft of information. For more information, see Implementing a Trade Secrets Protection Program.

Additionally, buyers should be mindful of federal, state, and local employment laws as tech-startups begin to scale and hire employees. Buyers also should ensure that each key employee has not engaged in conduct that could potentially lead to harassment claims and result in the dismissal of the key employee or damage to the company's reputation.

Over the past year, buyers have engaged in "social due diligence" for businesses that rely upon only a few key employees, requiring sellers to affirm that no allegations of sexual harassment have been made against any current or former executive of the company. Additionally, sellers have put money in escrow that buyers can claim if prior issues related to workplace conduct arise after the sale.

These type of clauses, sometimes referred to as "the Weinstein clause" or "#MeToo clauses" are designed to prevent financial and reputational damage from occurring after a sale. Some clauses include additional language requiring the target company to affirm that it has not entered into any settlement agreements related to workplace harassment.

At a minimum, buyers and their advisers should inquire about the target company's EEO policies, anti-harassment and anti-retaliation policies and procedures, including employee handbooks, and training efforts; what employee complaints the company has had and how they were handled; and whether there are any known sexual misconduct allegations against any top executives.

In summary, increased competition in the AV industry has resulted in a sharp increase in investment activity from traditional automakers, large tech companies, and venture capital firms. Due to the importance of retaining key employees, trade secrets, and confidential information, buyers should conduct thorough and rigorous due diligence to ensure the ability to protect trade secrets and confidential information, enforce non-competition agreements, and protect the purchaser from harassment and other employment related claims.

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